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We're life changing.

As the Chief Executive Officer and Chief Operating Officer of Federal Prison Industries, Inc. (FPI), we are pleased to present the Fiscal Year 2010 Annual Management Report to the Congress of the United States. This report includes FPI's commercial financial statements, Management Discussion and Analysis, Office of the Inspector General Commentary and Summary and the independent auditors' reports on the Corporation's financial statements, internal control over financial reporting, and compliance and other matters. FPI received an unqualified audit opinion on its financial statements and eliminated a significant deficiency in internal controls from the prior fiscal year.

The FPI program is one of the Bureau of Prisons' (BOP) most important correctional management programs. It was established by statute and Executive Order in 1934, to provide opportunities for education and work-related experiences to federal offenders. FPI is a unique organization with a complicated mission to employ and train as many Federal inmates as possible while maintaining its self-sufficiency at no cost to the taxpayer and minimizing the impact of private sector business. The program's real output, however, is inmates who are 24 percent less likely to recidivate and 14 percent more likely to be gainfully employed because of the job skills training and work experience they received in FPI.

National and global economic issues have adversely affected the Corporation's ability to increase inmate employment and produce positive earnings in recent years. With increased competition for government business, reduced discretionary spending of our government customers, and adverse legislation affecting FPI's mandatory source, it was necessary for FPI to reduce factory capacity and inmate employment levels to maintain self-sufficiency.

We are pleased to report that the actions taken over the past two years are achieving the intended results. FPI has effectively "right-sized" operations to meet customer requirements and improved efficiencies while reducing operating costs. As a result of these measures, FPI mitigated its negative earnings and maintained a stable cash position. We are confident that through our focus on continuous improvement, cost containment and new business development, FPI will successfully navigate the challenges of a growing inmate population and increasingly competitive business environment while preparing inmates for successful re-entry as we have since 1934.

Harley G. Lappin

Harley G. Lappin, Chief Executive Officer

Paul M. Laird, Chief Operating Officer

U.S. Department of Justice
Federal Prison Industries, Inc.
Management's Discussion and Analysis
(Unaudited)

Mission

It is the mission of Federal Prison Industries, Inc. (FPI) to employ and provide job skills training to the greatest practicable number of inmates confined within the Federal Bureau of Prisons; contribute to the safety and security of our Nation's federal correctional facilities by keeping inmates constructively occupied; provide market-quality products and services; operate in a self-sustaining manner; and minimize FPI's impact on private business and labor.

Organizational Structure of Federal Prison Industries, Inc.

FPI is a wholly-owned government corporation created by Congress in 1934. FPI is authorized to operate industries in federal correctional institutions and disciplinary barracks (18 U.S.C. § 4121 to § 4129). The Director of the Federal Bureau of Prisons (BOP), who has jurisdiction over all federal correctional institutions, is the Chief Executive Officer. General management of FPI is provided by the Chief Operating Officer who also serves as an Assistant Director for the BOP.

In fiscal year 2010, FPI operated in seven business segments: Clothing and Textiles, Electronics, Fleet Management and Vehicular Components, Industrial Products, Office Furniture, Recycling, and Services. FPI has industrial and service operations at 94 factories located at 70 prison locations representing approximately 9% of the work eligible inmate population as of September 30, 2010. Factories are operated by FPI supervisors and managers, who train and oversee the work of inmates. The factories utilize raw material and component parts purchased from the private sector to produce finished goods. Orders for goods and services are obtained through marketing and sales efforts managed by FPI staff. Some products and all services are provided on a non-mandatory, preferred source basis.

FPI processes primarily all customer orders and invoicing through a centralized customer service and accounts receivable center at the Lexington, Kentucky factory. Vendor payments are processed at a centralized accounts payable center at the Butner, North Carolina facility. In addition, FPI performs product development, testing and costing at its facility in Englewood, Colorado.

Financial Structure

FPI operates as a revolving fund and does not receive an annual appropriation. The majority of revenues are derived from the sale of products and services to other federal departments, agencies, and bureaus. Operating expenses such as the cost of raw materials and supplies, inmate wages, staff salaries, and capital expenditures are applied against these revenues resulting in operating income or loss, which is reapplied toward operating costs for future production. In this regard, FPI makes capital investments in buildings and improvements, machinery, and equipment as necessary in the conduct of its industrial operation.

While FPI does business with the majority of federal departments, agencies and bureaus, FPI's largest federal government customers include the Department of Defense (DOD), the Department of Homeland Security (DHS), the Department of Justice (DOJ), the Social Security Administration (SSA), and the General Services Administration (GSA).

Critical Accounting Policies

The following discussion and analysis of FPI's financial condition, results of operations, liquidity and capital resources are based upon FPI's financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles based on accounting standards issued by the Financial Accounting Standards Board (FASB), the private sector standards-setting body. These generally accepted accounting principles require FPI management to make estimates and judgments that affect the reported amount of assets, liabilities, revenues and expenses. In this regard, FPI management evaluates the estimates on an on-going basis, including those related to product returns, bad debt, inventories, long-lived assets, and contingencies and litigation. FPI bases its estimates upon historical experience and various other assumptions that FPI believes are reasonable under the circumstances. The actual results may differ from these estimates when assumptions or conditions change.

FPI believes that some of its accounting policies involve complex or higher degrees of judgment than its other accounting policies. The following accounting policies have been identified by FPI management as being critical and therefore require more significant estimates or reliance on a higher degree of judgment on the part of FPI management.

Revenue recognition: Revenue is generally recognized when 1) delivery has occurred or services have been rendered, 2) persuasive evidence of an arrangement exists, 3) there is a fixed or determinable price, and 4) collectability is reasonably assured. Revenue from contracts that specify a customer acceptance criteria is not recognized until either customer acceptance is obtained or upon completion of the contract. Sales returns are primarily replaced with like items and are recorded as they occur.

Revenue is recognized on multiple element (numerous stages of product delivery, set up, and installation) agreements as a single unit of accounting for manufactured items when the product has been accepted by the customer. Revenue for services provided on behalf of FPI is recognized when the service provider presents a valid invoice including a customer acceptance or completion notice.

Allowance for doubtful accounts receivable: The allowance for doubtful accounts is based upon an analysis of several factors including payment trends, historical write off experience, credit quality for non-governmental accounts, and specific analysis of collectability of an account. During the course of time, these factors may change which will cause the allowance level to adjust accordingly. As part of their analysis, customer accounts determined to be unlikely to be paid are recorded as a charge to bad debt expense in the income statement and the allowance account is increased. When it becomes certain that a customer account will not be paid, the receivable is written off by removing the balance from accounts receivable.

As of September 30, 2010 and September 30, 2009, FPI had established an allowance for bad debt in the amount of $.83 million and $.35 million on accounts receivable balances of $34.83 million and $56.06 million, respectively.

Inventory Valuation: FPI maintains its inventory primarily for the manufacture of goods for sale to its customers. FPI's inventory is composed of three categories: Raw Materials, Work-in-Process, and Finished Goods. These categories are generally defined by FPI as follows: Raw Materials consist of materials that have been acquired and are available for the production cycle, Work-in-Process is composed of materials that have moved into the production process and have some measurable amount of labor and overhead added by FPI, Finished Goods are materials with FPI added labor and overhead that have completed the production cycle and are awaiting sale to customers.

Raw material inventory value is based upon moving average cost. Inventories are valued at the lower of average cost or market value (LCM) and include materials, labor and manufacturing overhead. Market value is calculated on the basis of the contractual or anticipated selling price, less allowance for administrative expenses. FPI values its finished goods and sub-assembly items at a standard cost that is periodically adjusted to approximate actual cost. FPI has established inventory allowances to account for LCM adjustments and obsolete items that may not be utilized in future periods.

Program Values

It is the mission of Federal Prison Industries, Inc. (FPI) to employ and provide job skills training to the greatest practicable number of inmates confined within the Federal Bureau of Prisons; contribute to the safety and security of our Nation's federal correctional facilities by keeping inmates constructively occupied; provide market-quality products and services; operate in a self-sustaining manner; and minimize FPI's impact on private business and labor.

The goal of FPI is to reduce undesirable inmate idleness by providing a full-time work program for inmate populations (goal of approximately 25 percent of "work eligible" inmates). Many of the inmates do not have marketable skills. FPI provides a program of constructive industrial work and services wherein job skills can be developed and work habits acquired.

As with most governmental programs, the real value of the entity is not readily measured in dollars and cents and is not always contained in the financial reports. FPI has existed as an effective correctional program for 76 years. In the course of the years, FPI has positively impacted the lives of countless inmates and staff members that reside and work in the Bureau of Prisons and the surrounding local communities in which we live.

It is impossible to quantify the extent to which FPI's success has prevented inmate unrest that would have been costly in lives as well as dollars. In the face of an escalating inmate population and an increasing percentage of inmates with histories of violence, FPI's programs have helped ease tension and avert volatile situations, thereby protecting lives and federal property. Prisons without meaningful activities for inmates are dangerous prisons, and dangerous prisons are expensive prisons. The work and education programs of FPI have played an essential role in protecting lives, preserving stability and saving money in America's federal prisons.

At the same time, FPI has met its other goal of offering opportunities for inmates who want to take the personal responsibility for rehabilitating themselves. Most inmates eventually will be returned to society; industrial and educational programs can help them to steer clear of criminal activity after release. FPI plays a vital role in management of inmates, and also improves the likelihood that inmates will remain crime-free upon their release from BOP custody. A comprehensive study conducted by the BOP demonstrated that FPI provides inmates with an opportunity to develop work ethics and skills, contributes substantially to lower recidivism and increases job-related success of inmates upon release. This study indicates that inmates involved in FPI work programs and educational programs are substantially less likely to return to prison. The impact on the lives of people who live in the communities in which these inmates will return is immeasurable. Countless lives are spared the devastating impact of continued criminal activity.

Since coming into existence in the 1930s, FPI has been a reliable defense supplier, especially in times of surge demands. FPI has received a number of awards for its outstanding performance as a supplier to the DOD.

Analysis of Financial Statements

Cash and Investments

Total Cash increased $36.9 million, $35.6 million of which was the result of an increase in cash advances. FPI's cash advances are primarily for the purchase of inventory in support of the Fleet Management and Vehicular Components vehicle retrofitting operation. The primary customer for these operations is the Department of Homeland Security; advances fluctuate throughout the year as they receive appropriations. Other major factors in the overall change in cash include a $56.3 million loss, a decrease in Accounts Receivable of $21.7 and decrease in Inventories of $60.9 million.

Accounts Receivable

The Accounts Receivable balance decreased $21.7 million during fiscal year 2010, primarily as a result of a reduction in sales during the year and continued collection efforts. The Accounts Receivable balance of $34 million as of September 30, 2010 represents only 52.5 percent of September's total revenues. FPI collection efforts continued to improve during FY 2010. FPI was successful in maintaining its days to collect through enhanced results in the areas of electronic funds transfer and IPAC collections from the DOD. FPI's average days to collect for the year were approximately 24 and 18 in the month of September. The Accounts Receivable balance over sixty days old represented only 7 percent of the total balance as of September 30, 2010.

Inventory

Inventory decreased by $60.9 million during fiscal year 2010. FPI placed an increased emphasis on inventory reduction during fiscal year 2010. While some business segments achieved reductions, the Fleet Management and Vehicular Components business segment was the primary contributor to the reduction with a decrease of $53.2 million between September 2010 and September 2009. This decrease is attributable to the $58.2 million decrease in current backlog for the Fleet Management business segment as of September 30, 2010, compared to September 30, 2009. Modest increases resulted for Industrial Products and Office Furniture business segments, each of which had significant increases in backlog as of September 30, 2010.

Other Assets

In fiscal year 2010, other assets decreased by $2.3 million. During fiscal year 2008, FPI established a program to produce solar panels. Suppliers of solar panel raw materials require customers to advance funds to purchase materials. As of September 30, 2010, FPI has $2.7 million of outstanding advances for solar panel raw materials compared to $4.7 million as of September 30, 2009. The remaining balance is expected to be fully liquidated during fiscal year 2011.

Liabilities

Total Liabilities increased by $1.6 million during fiscal year 2010. Decreases in Accounts Payable were offset with increases in Deferred Revenue. Accounts Payable decreased $4.7 million during fiscal year 2010. The decrease is reflective of FPI's continued efforts to reduce costs and inventory. Deferred Revenue increased $6.9 million during fiscal year 2010. This 3.6 percent increase represents a change in customer advances payable on hand primarily for the retrofitting of vehicles for the DHS. The increase is insignificant considering the volume of the business segment which recorded $205.2 million in sales during fiscal year 2010.

Revenue, Cost of Revenue and Net Loss

Total Revenue decreased by $129.2 million while total cost of revenue decreased by $96.3 million. In fiscal year 2010, FPI incurred setbacks to its progress as a whole, including the loss of a major contract with the DOD for the sale of helmets, a delay in obtaining contracts for the newly developed solar panel product line and a significant decline in cable orders. The aforementioned factors contributed to a $45.4 million loss for the Electronics business segment and a corporate net loss of $56.3 million. The higher cost to revenue ratio is due primarily to write-offs for inventory in the Electronics business segment. These write-offs involved a $17.8 million write-off of military helmets and a write-down of solar cells and panels to market value in the amount of $17.3 million. A majority of these solar cells will be sold through GSA in early fiscal year 2011. In fiscal year 2010, five of seven business segments achieved increases in their earnings as a percentage of sales which gives a positive reflection of cost containment and factory capacity reductions. The Industrial

Products and Recycling business segments achieved the most remarkable changes with 29.4 and 29.7 percent increases respectively.

Business Segments

In fiscal year 2010, FPI's businesses were organized, managed and internally reported as seven operating segments based on products and services. These segments are Clothing and Textiles; Electronics; Fleet Management and Vehicular Components; Industrial Products; Office Furniture; Recycling; and Services. FPI is not dependent on any single product as a primary revenue source; however, it is dependent on the federal government market for the sale of its products. FPI's net industrial income (earnings) at the Business Segment level consist of sales offset by cost of goods sold and under /over applied overhead. Fiscal Year 2009 net sales of $885,265 included $(4,090) recorded to FPI's Corporate Office. Fiscal Year 2010 net sales of $776,984 included $4,088 recorded to FPI's Corporate Office. FPI's net sales and earnings for the fiscal years ended September 30, 2010 and 2009 for each of its current business segments is presented for comparative purposes:

Business Segment	Fiscal Year	
Clothing and Textiles	**2010**	**2009**
Sales	$246,470	$262,686
Earnings	$35,885	$36,165
Electronics		
Sales	$99,107	$161,525
Earnings	($45,360)	$6,224
Fleet Management and Vehicular Components		
Sales	$205,221	$261,242
Earnings	$7,029	$11,566
Industrial Products		
Sales	$44,029	$31,533
Earnings	$5,999	($4,969)
Office Furniture		
Sales	$129,312	$130,088
Earnings	$2,880	($2,994)
Recycling		
Sales	$13,596	$9,212
Earnings	$3,586	($308)
Services		
Sales	$35,161	$33,069
Earnings	($4,385)	($8,070)
Corporate Total		
Sales	$772,896	$889,355
Earnings	$5,634	$37,614

Liquidity and Capital Resources

Despite FPI's net loss of $56.3 million, total cash increased $36.9 million in fiscal year 2010. Much of this increase can be attributed to cash advances from customers, however, the cash balance (excluding advances) also increased in fiscal year 2010. The ending cash balance excluding advances was $189.1 million in fiscal year 2010 compared with $187.8 million in fiscal year 2009. In addition, FPI's cash still remains strong as a result of past DHS and DOD demand combined with current cost containment and factory capacity reductions. Factory earnings (before loss on closures and excess writeoff) are expected to increase to $24.5 million in fiscal year 2011 in comparison to

$17.9 million decrease in fiscal year 2010. Additional reductions in costs and investments in property, plant, and equipment were instituted in FPI's fiscal year 2011 operating plan.

Possible Future Effects of Existing Events and Conditions

In its fiscal year 2008 Management Discussion and Analysis, FPI reported a possible return to a tentative fiscal position once demand for products in support of the war subsided. Demand for these products gradually, but significantly declined over the course of fiscal year 2009. During fiscal year 2009, FPI faced many financial and operational challenges. While overall demand for FPI's products and services remained strong, profit margins were significantly lower than planned as the result of a product mix that included fewer high profit margin items typically produced for the war effort. As many of our competitors experienced a downturn in their business, competition for government business increased, pushing prices and profit margins lower. Adverse legislation in recent years made it significantly easier for private sector companies to increase its market share at FPI's expense. Increases in material prices and the cost of carrying excess production capacity and inventory also impacted FPI's profitability. The state of the economy yielded another unexpected turn as interest rates severely declined, becoming nearly non-existent. Historically, FPI has earned significant income from interest earned by investing its cash reserves.

FPI identified these trends early in fiscal year 2009 and instituted aggressive cost containment measures to minimize the overall impact on its financial position. These measures included a reduction in budgeted general and administrative expenses, actual overhead expenses and investment in property, plant and equipment. In order to achieve these goals, it was necessary to close or downsize 19 factories and reduce staff and inmate employment. Additionally, during fiscal year 2009, FPI placed an increased emphasis on marketing strategies. Additional reductions in costs and investment were instituted in FPI's fiscal year 2010 operating plan. FPI also supported additional legislative authorities to sustain its mission and offset legislation that was impacting the program.

In fiscal year 2010, FPI incurred some setbacks in its progress as a whole, including the loss of a major contract with the DOD for the sale of helmets, a delay in obtaining contracts for the newly developed solar panel product line and a significant decline in cable orders, all of which contributed to a $45.4 million loss for the Electronics business segment and a corporate net loss of $ 56.3 million.

However, these losses overshadowed some significant improvements in the remaining business segments. FPI continued to successfully reduce factory overhead, general and administrative expense and capital improvements. The financial impact of the fiscal year 2009 closures and downsizing became evident by the second quarter of fiscal year 2010. As staffing decreased, earnings for fiscal year 2010 improved drastically over that of fiscal year 2009. FPI's year to date net loss as of May 31, 2010 was $10.9 million compared to $18.8 million for the same period in fiscal year 2009. During June and July collectively, FPI earned $1.3 million and in August lost $4 million, primarily due to a once per annum excess and obsolete inventory write off of approximately $4 million. During fiscal year 2010, five of seven business segments increased their earnings compared to fiscal year 2009 and a sixth business segment (Clothing and Textiles), despite a six percent decline in sales, achieved a less than one percent decline in earnings. The Industrial Products business segment achieved its first positive earnings since fiscal year 2004. Assuming the Electronics business segment losses were factored out for fiscal years 2010 and 2009, the fiscal year 2010 net loss would have been $11.0 million versus a $29.6 million net loss for fiscal year 2009.

Unfortunately, despite the noted successes in fiscal year 2010, unused factory capacity necessitated the closure and downsizing of an additional 12 factories, (including three from the Electronics business segment) and personnel reductions in another eight locations. It is anticipated that these additional closures will net an additional annual savings of approximately $20 million once the new staffing level is realized.

Despite the net loss in fiscal year 2010, FPI also made some strides in improving its cash position through reductions in accounts receivable and capital expenditures. FPI has historically focused on cost containment measures, which has allowed it to build sufficient cash reserves during prosperous periods. FPI's fiscal year 2011 Operating Plan continues its focus on cost reductions. FPI is confident that by maintaining cost controls and continuing to undertake new marketing initiatives, it will continue to meet its mission challenges of maintaining a 'self-sufficient' fiscal position and providing adequate inmate employment levels and will ensure it has resources to sustain future operations.

FEDERAL PRISON INDUSTRIES, INC.
ANNUAL MANAGEMENT REPORT
FISCAL YEAR 2010

OFFICE OF THE INSPECTOR GENERAL
COMMENTARY AND SUMMARY

This audit report contains the Annual Management Report of the Federal Prison Industries, Inc. (FPI) for the fiscal years (FY) ended September 30, 2010, and September 30, 2009. In accordance with the Government Corporation Control Act, as amended (31 U.S.C. §9105), and under the direction of the Office of the Inspector General (OIG), Cotton & Company LLP performed the audit in accordance with U.S. generally accepted government auditing standards. The audit resulted in an unqualified opinion on the FY 2010 financial statements. An unqualified opinion means that the financial statements present fairly, in all material respects, the financial position and the results of the entity's operations in conformity with U.S. generally accepted accounting principles. The FY 2009 financial statement audit was performed by KPMG LLP and also resulted in an unqualified opinion (OIG Report No. 10-08).

Cotton & Company LLP also issued reports on internal control and on compliance and other matters. For FY 2010, the *Independent Auditors' Report on Internal Control over Financial Reporting* did not identify any significant deficiencies. In the FY 2010 *Independent Auditors' Report on Compliance and Other Matters*, the auditors identified no instances of non-compliance with applicable laws and regulations.

The OIG reviewed Cotton & Company LLP's reports and related documentation and made necessary inquiries of its representatives. Our review, as differentiated from an audit in accordance with U.S. generally accepted government auditing standards, was not intended to enable us to express, and we do not express, an opinion on the FPI's financial statements, conclusions about the effectiveness of internal control, conclusions on whether the FPI's financial management systems substantially complied with the *Federal Financial Management Integrity Act of 1996*, or conclusions on compliance with laws and regulations. Cotton & Company LLP is responsible for the attached auditors' reports dated November 1, 2010, and the conclusions expressed in the reports. However, our review disclosed no instances where Cotton & Company LLP did not comply, in all material respects, with U.S. generally accepted government auditing standards.

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Independent Auditors' Report on Financial Statements

Inspector General
United States Department of Justice

Harley G. Lappin, Chief Executive Officer
Board of Directors
Federal Prison Industries, Inc.
United States Department of Justice

We have audited the accompanying Balance Sheet of the Federal Prison Industries, Inc. (FPI), a component of the United States Department of Justice (DOJ), as of September 30, 2010, and the related Statement of Operations and Cumulative Results of Operations, and Statement of Cash Flows for the year then ended. These financial statements are the responsibility of the FPI's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the FPI as of September 30, 2009, were audited by other auditors whose report dated November 6, 2009, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements,* as amended by OMB Memorandum M-09-33. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the FPI's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used, and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the FPI, as of September 30, 2010, and the results of its operations and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The information in the *Management's Discussion and Analysis* section is not a required part of the basic financial statements, but is supplementary information required by U.S. generally accepted accounting principles, or by OMB Circular No. A-136, *Financial Reporting Requirements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 1, 2010, on our consideration of the FPI's internal control over financial reporting and on our tests of its compliance with certain provisions of applicable laws and regulations. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in assessing the results of our audit.

COTTON & COMPANY LLP

Alan Rosenthal, CPA, CFE
Partner

November 1, 2010
Alexandria, Virginia

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Independent Auditors' Report on Internal Control over Financial Reporting

Inspector General
United States Department of Justice

Harley G. Lappin, Chief Executive Officer
Board of Directors
Federal Prison Industries, Inc.
United States Department of Justice

We have audited the Balance Sheet of the Federal Prison Industries, Inc. (FPI), a component of the United States Department of Justice (DOJ), as of September 30, 2010, and the related Statement of Operations and Cumulative Results of Operations, and Statement of Cash Flows for the year then ended, and have issued our report thereon dated November 1, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended by OMB Memorandum M-09-33. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit, we considered the FPI's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the FPI's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the FPI's internal control over financial reporting or on management's assertion on internal control included in *Management's Discussion and Analysis*. We limited our internal control testing to only those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 07-04. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*, such as controls relevant to ensuring efficient operations.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the second paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. In our fiscal year 2010 audit, we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

We provide the current status of open recommendations from prior years in the following exhibit.

This report is intended solely for the information and use of the FPI management, DOJ Office of the Inspector General, DOJ Justice Management Division, OMB, the U.S. Government Accountability Office, and the U.S. Congress; it is not intended to be and should not be used by anyone other than these specified parties.

COTTON & COMPANY LLP

Alan Rosenthal, CPA, CFE
Partner

November 1, 2010
Alexandria, Virginia

STATUS OF PRIOR YEARS' FINDINGS AND RECOMMENDATIONS

As required by *Government Auditing Standards* issued by the Comptroller General of the United States, and by OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, we have reviewed the status of prior years' findings and recommendations. The following table provides our assessment of the progress the FPI has made in correcting the significant deficiencies identified during these audits. We also provide the Office of the Inspector General report number where the deficiency remains open, the fiscal year it was identified, the recommendation for improvement, and the status of the recommendation as of the end of fiscal year 2010:

Report	Significant Deficiency	Recommendation	Status
Annual Financial Statement Fiscal Year 2009 Report No. 10-07	Improvements are needed in Inventory Controls.	**Recommendation No. 1:** Emphasize the importance of adhering to the proper segregation of duties regarding inventory count duties for both the cycle counts and the work in process inventory counts, the necessity to perform these inventory counts properly, the requirement for proper review and authorization of adjusting entries resulting from the inventory counts, and the need to maintain complete files documenting the performance and results of inventory counts.	Completed
		Recommendation No. 2: Consider reviewing and testing the adequacy of the performance of inventory counts. FPI management may consider utilizing the Program Review Division or utilizing headquarters management and staff to observe and document the performance of inventory counts in order to identify performance matters for improving the inventory count processes.	Completed

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Independent Auditors' Report on Compliance and Other Matters

Inspector General
United States Department of Justice

Harley G. Lappin, Chief Executive Officer
Board of Directors
Federal Prison Industries, Inc.
United States Department of Justice

We have audited the Balance Sheet of the Federal Prison Industries, Inc. (FPI), a component of the United States Department of Justice (DOJ), as of September 30, 2010, the related Statement of Operations and Cumulative Results of Operations, and the Statement of Cash Flows for the year then ended, and have issued our report thereon dated November 1, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended by OMB Memorandum M-09-33.

The FPI's management is responsible for complying with laws, regulations, and contract agreements applicable to the FPI. As part of obtaining reasonable assurance about whether the FPI's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contract agreements, noncompliance with which could have a direct and material effect on the determination of the financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including the provisions referred to in Section 803(a) of the *Federal Financial Management Improvement Act of 1996* (FFMIA). However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests of compliance described in the preceding paragraph of this report, exclusive of those referred to in FFMIA, disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 07-04.

Under FFMIA, we are required to report whether the FPI's financial management systems substantially comply with federal financial management systems requirements; applicable federal accounting standards; and application of the United States Standard General Ledger at the transaction level based upon U.S. generally accepted accounting principles issued by the Financial Accounting Standards Board, as applicable to the FPI in accordance with the provisions of the Government Corporation Control Act of 1945 (31 U.S.C. §9101 to 9110) and Statement of Federal Financial Accounting Standards No. 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*. To meet this requirement, we performed tests of compliance with FFMIA section 803(a) requirements.

The results of our tests of FFMIA disclosed no instances in which the FPI's financial management systems did not substantially comply with the requirements described in the preceding paragraph.

This report is intended solely for the information and use of the FPI's management, DOJ Office of the Inspector General, DOJ Justice Management Division, OMB, the U.S. Government Accountability Office, and the U.S. Congress; it is not intended to be and should not be used by anyone other than these specified parties.

COTTON & COMPANY LLP

Alan Rosenthal, CPA, CFE
Partner

November 1, 2010
Alexandria, Virginia

Federal Prison Industries, Inc.

Balance Sheets

As of September 30, ***(DOLLARS IN THOUSANDS)***	**2010**	**2009**
Assets		
Current:		
Cash and cash equivalents	$ 322,448	$ 285,559
Accounts receivable, net	34,006	55,712
Inventories, net	203,331	264,232
Other assets	3,691	5,962
Total current assets	563,476	611,465
Property, plant and equipment, net	116,896	123,684
Total Assets	$ 680,372	$ 735,149
Liabilities and United States Government Equity		
Current:		
Accounts payable	$ 43,359	$ 48,103
Deferred revenue	198,217	191,314
Accrued salaries and wages	11,244	11,484
Accrued annual leave	9,911	10,363
Other accrued expenses	9,950	11,780
Total current liabilities	272,681	273,044
FECA actuarial liability	15,857	13,943
Total Liabilities	288,538	286,987
United States Government Equity		
Initial capital	4,176	4,176
Cumulative results of operations	387,658	443,986
Total United States Government Equity	391,834	448,162
Total Liabilities and United States Government Equity	$ 680,372	$ 735,149

The accompanying notes are an integral part of these financial statements.

Federal Prison Industries, Inc.

Statements of Operations and Cumulative Results of Operations

For the fiscal years ended September 30, (DOLLARS IN THOUSANDS)	2010	2009
Revenue:		
Net sales	$ 776,984	$ 885,265
Other revenue	77,025	97,962
Total revenue	854,009	983,227
Cost of revenue:		
Cost of sales	763,327	833,083
Cost of other revenue	75,267	101,829
Total Cost of Revenue	838,594	934,912
Gross profit	15,415	48,315
Operating expenses:		
Sales and marketing	5,907	6,364
General and administrative	106,535	120,241
Total operating expenses	112,442	126,605
Loss from operations	(97,027)	(78,290)
Interest income	259	423
Interest expense	(4)	(17)
Other income, net	40,444	42,015
Net loss	(56,328)	(35,869)
Cumulative results of operations, beginning of fiscal year	443,986	479,855
Cumulative results of operations, end of fiscal year	$ 387,658	$ 443,986

The accompanying notes are an integral part of these financial statements.

Federal Prison Industries, Inc.

Statements of Cash Flows

For the fiscal years ended September 30, *(DOLLARS IN THOUSANDS)*	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$ (56,328)	$ (35,869)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	11,120	10,739
Loss on disposal of property, plant and equipment	4,079	7,970
Changes in:		
Accounts receivable	21,706	(10,843)
Inventories	60,901	(14,116)
Other assets	2,271	2,625
Accounts payable and accrued expenses	(5,352)	(19,299)
Deferred revenue	6,903	(17,597)
Net cash provided by (used in) operating activities	45,300	(76,390)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property, plant and equipment	(8,416)	(8,972)
Construction-in-progress of plant facilities	5	(1,770)
Net cash used in investing activities	(8,411)	(10,742)
Net increase (decrease) in cash and cash equivalents	36,889	(87,132)
Cash and cash equivalents, beginning of fiscal year	285,559	372,691
Cash and cash equivalents, end of fiscal year	$ 322,448	$ 285,559

The accompanying notes are an integral part of these financial statements.

Note 1. Organization and Mission

Federal Prison Industries, Inc. (FPI) was established in 1934 by an act of the United States Congress. FPI operates under the trade name UNICOR, as a wholly-owned federal government corporation within the Department of Justice, and functions under the direction and control of a Board of Directors, (the "Board"). Members of the Board are appointed by the President of the United States of America and represent retailers and consumers, agriculture, industry, labor, the Attorney General, and the Secretary of Defense. FPI's statutory mandate is to provide employment and training for inmates in the Federal Prison System while remaining self-sufficient through the sale of its products and services.

FPI's federal government customers include departments (percent of Revenue shown in parenthesis), agencies and bureaus such as the Department of Defense (46%), the Department of Homeland Security (23%), the Department of Justice (10%), the Social Security Administration (4%), and the General Services Administration (4%). These and other federal organizations are generally required to purchase products from FPI, if its products meet the customer's price, quality, and delivery standards, under a mandatory source preference specified in FPI's enabling statute and the Federal Acquisition Regulation.

FPI has industrial and service operations at 94 and 98 factories located at 70 and 71 prison facilities that employed 15,907 and 18,972 inmates representing approximately 9% and 16% of the work eligible inmate population as of September 30, 2010 and September 30, 2009, respectively.

Note 2. Summary of Significant Accounting Policies

Basis of Accounting

FPI transactions are recorded on the accrual basis of accounting. Under the accrual basis, revenues are recorded when earned and expenses are recorded when incurred, regardless of when the cash is exchanged.

Basis of Presentation

FPI has historically prepared its external financial statements in conformity with U.S. generally accepted accounting principles based on accounting standards issued by the Financial Accounting Standards Board (FASB), the private sector standards-setting body. The Federal Accounting Standards Advisory Board (FASAB) has been designated as the standards-setting body for federal financial reporting entities with respect to the establishment of US GAAP. FASAB allows certain government agencies to utilize FASB standards for Financial Statement presentations.

Use of Estimates

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and contingent liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

Cash and Cash Equivalents

FPI considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. FPI limits its investment activities and cash equivalents to short-term overnight repurchase agreements with the Bureau of Public Debt of the United States Treasury. The market value of these overnight repurchase agreements is equivalent to cost.

Accounts Receivable / Concentration of Credit Risk

Financial instruments that potentially subject FPI to concentrations of credit risk consist primarily of accounts receivable. FPI sells products and services to various federal government departments, agencies and bureaus, as well as certain private sector companies, without requiring collateral. Accounts receivable consists of amounts due from those entities and is stated net of an allowance for doubtful accounts.

FPI routinely assesses the payment histories of its federal customers and the financial strength of its private sector customers and maintains allowances for anticipated losses as they become evident. In this regard, an insignificant amount of accounts receivable remained past due at September 30, 2010 and September 30, 2009. A majority of these past due items relate to billings to various entities within Department of Defense (DOD) who rely on the Defense Finance and Accounting Service (DFAS) to process vendor payments. Historically, customer payments processed through DFAS have generally taken longer to receive than payments from other federal and private sector customers. FPI believes that ultimately, a majority of its past-due accounts receivable are fully collectable. The amount due FPI, net of allowances, from DOD for the fiscal years ended September 30, 2010 and 2009 was $19,067 and $38,037 respectively.

While federal accounts receivable are normally fully collectible in accordance with federal law, FPI has established an allowance for future losses against its federal accounts receivable to account for potential billing errors related to pricing and customer discounts, as well as instances of expired or cancelled funding from its federally appropriated customers. At September 30, 2010 and 2009, FPI's allowance for doubtful accounts is stated at approximately $825 and $345, respectively, of which approximately $224 and $285, respectively, represents the amounts allocated against federal accounts receivable.

Inventories

FPI maintains its inventory primarily for the manufacture of goods for sale to its customers. FPI's inventory is composed of three categories: Raw Materials, Work-in-Process, and Finished Goods. These categories are generally defined by FPI as follows: Raw Materials consist of materials that have been acquired and are available for the production cycle, Work-in-Process is composed of materials that have moved into the production process and have some measurable amount of labor and overhead added by FPI, Finished Goods are materials with FPI added labor and overhead that have completed the production cycle and are awaiting sale to customers.

Raw material inventory value is based upon moving average cost. Inventories are valued at the lower of average cost or market value (LCM) and include materials, labor and manufacturing overhead. Market value is calculated on the basis of the contractual or anticipated selling price, less allowance for administrative expenses. FPI values its finished goods and sub-assembly items at a standard cost that is periodically adjusted to approximate actual cost. FPI has established inventory allowances to account for LCM adjustments and obsolete items that may not be utilized in future periods.

Advances to Vendors

FPI generally does not offer advances to the public, however, where warranted, FPI will on occasion make an advance to a vendor upon their request. Historically, these advances have been insignificant and made primarily to the Industries for the Blind. During 2008, FPI established a program to produce solar panels in anticipation of an expanding federal market as a result of Executive Order 13423 "Strengthening Federal Environmental, Energy, and Transportation Management," which requires federal agencies to improve energy efficiencies by the year 2015. Customarily, suppliers of the raw materials to produce solar panels require advances to procure their own materials. Prior to issuing any advances to a vendor, the Centralized Accounts Receivable section performs a review as though they were a public customer, to include performing a due diligence review to assess risk and a review of applicant financial statements. A letter of credit is obtained as needed based on the results of this review. The FPI Controller approves advances prior to their disbursement. Advances are reduced by offset to the vendor invoice as goods are delivered.

Revenue Recognition

FPI sells a wide range of products and services to a diversified base of customers, primarily governmental departments, agencies and bureaus. Revenue is generally recognized when delivery has occurred or services have been rendered, persuasive evidence of an arrangement exists, there is a fixed or determinable price, and collectability is reasonably assured. Revenue from contracts that require customer acceptance are not recognized until either customer acceptance is obtained, or upon completion of the contract. Sales returns are primarily replaced with like items and are recorded as they occur.

Revenue is recognized on multiple element agreements as a single unit of accounting for manufactured items when the product has been accepted by the customer. Revenue for services provided on behalf of FPI is recognized when the service provider presents a valid invoice including a customer acceptance or completion notice.

FPI records as other revenue the shipping and handling costs that have been billed to our customers, installation costs for FPI products, and items procured for its customers as part of procurement services provided by the Interagency Solutions and Procurement Branch. The cost of providing this service is recorded as a cost of other revenue.

Deferred revenue is comprised of customer cash advances, which have been paid to FPI prior to the manufacturing of goods, delivery of goods, or performance of services.

Other income is comprised primarily of imputed financing for retirement, health benefits and life insurance (Note 8).

Property, Plant and Equipment

Property, plant and equipment are stated at cost, net of accumulated depreciation. Depreciation is computed using the straight-line method over the following estimated useful lives:

	Years
Machinery & Equipment	5 - 25
Computer Hardware	5 - 10
Computer Software	3 - 5
Building & Improvements	24- 40

Upon retirement or disposition of property and equipment, the related gain or loss is reflected in the statements of operations. Repairs and maintenance costs are expensed as incurred.

Taxes

As a wholly-owned corporation of the federal government, FPI is exempt from federal and state income taxes, gross receipts tax, and property taxes.

Reclassifications

Certain fiscal year 2009 financial statement line items have been reclassified to conform with the current year presentation.

(DOLLARS IN THOUSANDS)

Note 3. Accounts Receivable, Net

Accounts receivable, net consists of the following:

As of September 30,	2010	2009
Intragovernmental billed receivables	$ 25,443	$ 47,083
Private sector billed receivables	9,388	8,974
	34,831	56,057
Less allowance for doubtful accounts	825	345
Accounts receivable, net	$ 34,006	$ 55,712

FPI incurred bad debt expense of $546 and $(530), respectively, for the fiscal years ended September 30, 2010 and 2009.

FPI incurred minimal direct accounts receivable write-offs during fiscal year 2009. The net downward adjustment of $645 to allowance for doubtful accounts during fiscal year 2009 resulted in negative bad debt expense. FPI's accounting policy regarding the recording of allowance for doubtful accounts is discussed in note 2 – Accounts Receivable / Concentration of Credit Risk.

Note 4. Inventories, Net

Inventories, net consist of the following:

As of September 30,	2010	2009
Raw materials	$ 103,411	$ 75,114
Raw materials – vehicles	50,298	91,890
Work-in-process	31,312	41,916
Finished sub-assemblies	8,576	8,577
Finished goods	36,399	38,050
Finished goods – acceptance contracts	22,074	20,899
	252,070	276,446
Less inventory allowance	48,739	12,214
Inventories, net	$ 203,331	$ 264,232

$50,298 of FPI's fiscal year 2010 and $91,890 of FPI's fiscal year 2009, raw materials balance represents vehicles and component parts for use in the Fleet Management and Vehicular Components business group's retrofit product line. A majority of that inventory balance has been contracted on behalf of the Customs and Border Protection and Bureau of Immigration and Customs Enforcement of the Department of Homeland Security (DHS) for retrofit services that are performed by FPI. As part of an interagency agreement, DHS provides advance funding to FPI to procure these vehicles. Revenue is recognized by FPI at the time of shipment of retrofitted vehicles to DHS.

(DOLLARS IN THOUSANDS)

$22,074 of FPI's fiscal year 2010 and $20,899 of its fiscal year 2009 finished goods balance represents goods shipped to customers or their agents for unrecognized revenue due to acceptance criteria within the customer contract. The balances as of September 30, 2010 and September 30, 2009 are primarily systems furniture installations and destination acceptance contracts shipped after the cutoff date for revenue recognition.

Included in total inventories as of September 30, 2010 and September 30, 2009, is $42,393 and $22,752 in raw materials, work-in-process and finished goods in support of the newly activated solar panels product line respectively. Additionally, FPI has entered into firm purchase commitments for solar panel materials totaling $25,485 to be delivered in fiscal year 2011 and $23,671 to be delivered in fiscal year 2014.

Note 5. Property, Plant and Equipment, Net

Property, plant and equipment, net consist of the following:

As of September 30,	**2010**	**2009**
Buildings and improvements	$ 179,656	$ 181,290
Machinery and equipment	109,453	105,401
Computer hardware	1,970	1,872
Computer software	6,484	6,304
	297,563	294,867
Less accumulated depreciation	180,667	173,001
	116,896	121,866
Factory construction-in-progress	-	1,818
Property, plant and equipment, net	$ 116,896	$ 123,684

Depreciation and amortization expense totaled $11,120 and $10,739 for the fiscal years ended September 30, 2010 and 2009, respectively. During fiscal year 2010, FPI invested $8,417 for the purchase and construction of property, plant and equipment. During fiscal years 2010 and 2009, FPI deactivated factories in an effort to reduce excess factory capacity. As a result of these deactivations, FPI incurred losses on property plant and equipment of $4,039 in fiscal year 2010 and $7,746 in fiscal year 2009.

(DOLLARS IN THOUSANDS)

Note 6. Other Accrued Expenses

Other accrued expenses consist of the following:

As of September 30,	2010	2009
Materials in transit	$ 1,607	$ 1,580
Relocation travel expense	1,107	2,191
FECA liabilities – current portion	1,656	1,643
Financial audit expense	461	549
Telecommunication expense	934	1,174
Utilities	1,204	1,401
Warranty expense	451	478
Other expense	2,530	2,764
Other accrued expenses	$ 9,950	$ 11,780

Included in other expense as of September 30, 2010 and September 30, 2009 are accruals for Intra-Departmental agreements of $501 and $73 and accruals for vendor invoices of $1,292 and $1,486, respectively.

Note 7. Business Segments

FPI's businesses are organized, managed and internally reported as seven operating segments based on products and services. These segments are Clothing and Textiles; Electronics; Fleet Management and Vehicular Components; Industrial Products; Office Furniture; Recycling; and Services. These segments represent virtually all of FPI's product lines. FPI is not dependent on any single product as a primary revenue source; however, it is dependent on the federal government market for the sale of its products and services. Fiscal year 2009 net sales of $885,265 included $(4,090) recorded to FPI's Corporate Office. Fiscal year 2010 net sales of $776,984 included $4,088 recorded to FPI's Corporate Office. FPI's net sales for the fiscal years ended September 30, 2010 and 2009 for each of its business segments is presented for comparative purposes:

(DOLLARS IN THOUSANDS)

Net Sales

For the years ended September 30,	**2010**	**2009**
Business Segment		
Clothing and Textiles	$ 246,470	$ 262,686
Electronics	99,107	161,525
Fleet Management and Vehicular Components	205,221	261,242
Industrial Products	44,029	31,533
Office Furniture	129,312	130,088
Recycling	13,596	9,212
Services	35,161	33,069
Net sales	$ 772,896	$ 889,355

Regulatory Compliance

FPI's ability to add or to expand production of a specified product is regulated by the Federal Prison Industries Reform Act ("the Act"). The Act provides specific guidelines to FPI regarding its methodology for evaluating and reporting new or expanded products, including requiring FPI to provide direct notice to trade associations and interested parties of such actions. Finally, publication of annual decisions of the FPI Board of Directors and semi-annual sales disclosures are mandated under the Act.

Note 8. Intra-Department of Justice (DOJ) / Intragovernmental Financial Activities

FPI's financial activities interact with and are dependent upon those of DOJ and the federal government as a whole. The following is a discussion of certain intra-DOJ and intragovernmental activities and their relationship with FPI:

Relationship with the Federal Bureau of Prisons

FPI and the Federal Bureau of Prisons (BOP) have a unique relationship in that the nature of their respective missions requires the sharing of facilities and responsibilities relative to the custody, training and employment of federal inmates. The Director of the BOP serves as the Chief Executive Officer of FPI and the Chief Operating Officer of FPI serves as an Assistant Director of the BOP. The BOP provides land to FPI for the construction of its manufacturing facilities and both FPI and BOP share certain facilities, generally at no cost to FPI. In accordance with Managerial Cost Accounting Concepts a reasonable estimate of these costs as provided by the BOP is included in general expense and other income of FPI for the fiscal years ended September 30, 2010 and 2009, respectively.

Self Insurance

In accordance with federal government policy, FPI is uninsured with respect to property damage, product liability, and other customary business loss exposures. Losses incurred are absorbed as a current operating expense of FPI or, if they are induced by factors related to FPI's relationship with the Federal Prison System, may be reimbursed by BOP. Certain other costs, principally relating to personal injury claims, are paid directly by the federal government.

Federal Employees Compensation Act

The Federal Employees Compensation Act (FECA) provides income and medical cost protection to cover federal civilian employees injured on the job, employees who have incurred a work-related occupational disease, and beneficiaries of employees whose death is attributable to a job related injury or occupational disease. The United States Department of Labor (DOL), which administers FECA, annually charges each federal agency and department for its applicable portion of claims and benefits paid in the preceding year. As of September 30, 2010 and September 30, 2009, the accrued FECA liabilities as charged to FPI, approximated $1,656 and $1,643, respectively.

DOL also calculates the liability of the federal government for future claims and benefits, which includes the estimated liability of death, disability, medical, and other approved costs. Future claims and benefits are determined from an actuarial extrapolation, utilizing historical benefit payment patterns and calculations of projected future benefit payments discounted to current value over a 23.5 year period. FPI's estimated future liability approximated $15,857 and $13,943 at September 30, 2010 and 2009, respectively.

Retirement

Substantially all of FPI's civilian employees are covered under either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). For employees covered under CSRS (those employees hired prior to January 1, 1984), FPI contributed approximately 30.1 percent (for normal retirement) or 51.1 percent (for hazardous duty retirement) of each employee's salary. CSRS covered employees do not have Federal Insurance Contributions Act (FICA) withholdings and, thus, are not fully eligible to receive Social Security benefits. For employees covered by the FERS, (generally those employees hired on or after January 1, 1984), FPI contributed (for normal retirement) 13.8 percent for fiscal year ended September 30, 2010 and 11.2 percent for the fiscal year ended September 30, 2009. FPI contributed (for hazardous retirement) 29.8 percent for fiscal years ended September 30, 2010 and 24.9 percent for the fiscal year ended September 30, 2009.

Under FERS, employees also receive retirement benefits from Social Security and, if applicable, benefits from a defined contribution plan (thrift). Under the thrift plan, an employee may contribute (tax deferred) to an investment fund, up to $16,500 of salary for the fiscal years ended September 30, 2010 and September 30, 2009. FPI then matches this amount up to 4 percent, in addition to an automatic 1 percent that is contributed for all FERS employees. Those employees, which elected to remain under CSRS after January 1, 1984, continue to receive benefits in place, and may also contribute (tax deferred) up to 10 percent of their salary to the thrift plan, but with no matching amount contributed by FPI.

CSRS and FERS are multi-employer plans. Although FPI funds a portion of pension benefits relating to its employees, and provides for the necessary payroll withholdings, it does not maintain or report information with respect to the assets of the plans, nor does it report actuarial data with respect to accumulated plan benefits or the pension liability relative to its employees. The reporting of such amounts is the responsibility of the United States Office of Personnel Management (OPM).

FPI's contribution to both plans approximated $31,465 and $32,325 for the fiscal years ended September 30, 2010 and 2009, respectively.

FPI must recognize its share of the cost of providing pension benefits to eligible employees utilizing cost factors determined by the OPM. Included in general and administrative expense is approximately $2,209 and $1,043 in the fiscal years ended September 30, 2010 and 2009, respectively, with an offsetting credit to other income on the Statements of Operations and Cumulative Results of Operations.

Health Benefits and Life Insurance

FPI, through the OPM, offers health and life insurance plans under which premium costs for health care are shared between FPI and the employees. A substantial portion of life insurance premiums are paid for by employees. Amounts paid by FPI for health benefits and life insurance approximated $10,739 and $10,667 for the fiscal years ended September 30, 2010 and 2009, respectively.

OPM also provides health care and life insurance benefits for FPI's retired employees. FPI must recognize an expense related to its share of the cost of such post-retirement health benefits and life insurance on a current basis (while its employees are still working), with an offsetting credit to other income. Costs in this regard, which approximated $7,778 and $8,365 during the fiscal years ended September 30, 2010 and 2009, respectively, were determined by OPM utilizing cost factors used to estimate the cost of providing post-retirement benefits to current employees. However, because of the offsetting credit, which is reflected as other income on the Statements of Operations and Cumulative Results of Operations, the recording of these costs has no impact on reported net income or cash flows.

Future post-retirement health care and life insurance benefit costs are not reflected as a liability on FPI's financial statements, as such costs are expected to be funded in future periods by OPM.

(DOLLARS IN THOUSANDS)

Note 9. Sales and Marketing, General and Administrative Expenses

Sales and marketing, general and administrative expenses consist of the following:

Sales and marketing, general and administrative expenses ***Fiscal years ended September 30,***	**2010**	**2009**
Salaries, wages and benefits	$ 47,841	$ 47,893
Permanent change of station expense	700	2,604
Purchases of minor equipment	389	1,076
Contract services	9,225	10,282
Bad debt expense	539	(516)
Credit card service fees	1,093	1,051
Travel	1,723	2,646
Personal computer expense	910	3,508
Accident compensation	3,482	3,521
Financial audit	1,681	2,046
Marketing	1,791	2,144
Depreciation	2,005	2,033
Gain on disposition of assets	(11)	(52)
Loss on disposition of assets	4,079	7,970
Telecommunication expense	3,159	3,097
Other expense	(3,599)	(460)
Imputed pension costs (Note 8)	2,209	1,043
Imputed post-retirement health care and life insurance cost (Note 8)	7,778	8,365
Imputed operating costs	27,448	28,354
Sales and marketing, general and administrative expenses	$ 112,442	$ 126,605

Other expense is comprised primarily of inmate wages, maintenance agreements, and distributions to factory operations. Contract services consist primarily of consulting and sales and marketing fees. Salaries, wages and benefits are shown net of the imputed financing offsetting credit (Note 8).

(DOLLARS IN THOUSANDS)

Note 10. Commitments and Contingencies

Legal Contingencies

FPI is party to various administrative proceedings, legal actions, and claims. FPI was party to no legal proceedings that are expected to result in a probable loss; accordingly, the balance sheets contain no liabilities for contingencies. Legal actions where management and the Chief Council consider adverse decisions reasonably possible and the amounts are reasonably estimable, should not result in judgments which would have a material adverse effect on the organizations financial statements. Furthermore, there are cases where amounts have not been accrued or disclosed because the amounts of the potential loss cannot be estimated or the likelihood of an unfavorable outcome is considered remote.

Lease Commitments

FPI leases certain facilities, machinery, vehicles and office equipment under noncancelable capital and operating lease agreements that expire over future periods. Many of these lease agreements provide FPI with the option (after initial lease term) to either purchase the leased item at the then fair value or to renew the lease for additional periods of time. As of September 30, 2010, future capital lease payments due and future operating lease commitments total $114 and $96, respectively.

Product Warranty

FPI offers its customers a promise of an "Escape Proof Guarantee" on the products it manufactures. FPI has analyzed the historical pattern of warranty returns and the adequacy of the warranty returns and allowances. In this regard, FPI has established an estimate of future warranty returns related to current period product revenue.

Changes in aggregate product warranty liability ***Fiscal years ended September 30,***	**2010**	**2009**
Balance at the beginning of the period	$ 478	$ 471
Accruals for warranties issued during the period	342	377
Settlements made (in cash or in kind) during the period	(369)	(370)
Balance at the end of the period	$451	$ 478

Fiscal Years 2010 and 2009
Notes to Financial Statements
(DOLLARS IN THOUSANDS)

Congressional Limitation on Administrative Expenses

Congress has imposed an annual spending limit on certain administrative expenses relating to FPI's central office management. These costs include salaries for management personnel, travel expenses and supplies. The following is a comparison of actual expenses to the limitation imposed:

Congressional limitation on administrative expenses

Fiscal years ended September 30,	**2010**	**2009**
Congressional limitation on expenses	$ 2,700	$ 2,328
Expenses incurred subject to Congressional limitation	$ 2,025	$ 2,323